

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Monteith Analyst: Roger Lackey Bill Number: SB 1336

Related Bills: See Prior Analysis Telephone: 845-3627 Amended Date: 04-06-00

Attorney: Patrick Kusiak Sponsor:

SUBJECT: United States Small Business Administration Guaranty Fees Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED January 5, 2000, STILL APPLIES.

OTHER - See comments below.

SUMMARY OF BILL

This bill would provide a credit equal to:

- Ⓟ the amount paid to the U.S. Small Business Administration (SBA) as a guaranty fee related to obtaining guaranteed financing, plus
- Ⓟ an amount equal to any fees or other costs paid to obtain the SBA loan, but not to exceed \$1,000.

SUMMARY OF AMENDMENT

The April 6, 2000, amendment expanded the credit to include any fees or other costs paid to obtain a loan guaranteed by the SBA, including lender fees, appraisal costs and administrative fees. The amendment provided that the credit amount related to these fees and other costs could not exceed \$1,000.

Also, the amendment deleted a requirement that the guaranty fee credit be allowed only to businesses in counties with an unemployment rate twice that of the state. Instead, the bill now expands the availability of the credit. To qualify, the principal place of the taxpayer's business must be in a county in this state that has an unemployment rate that is 150% of the state average unemployment rate for the 12 months preceding the month the loan proceeds subject to the guaranty fee are disbursed and the guaranty fee is paid, or the business must be located in an area designated as an enterprise zone.

In addition, the amendment added a sunset date so that the credit would be operative for taxable and income years beginning on or after January 1, 2000, and before January 1, 2008.

Board Position:

<u> </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> X PENDING

Legislative Director

Date

Johnnie Lou Rosas

4/21/00

As a result of the April 6, 2000, amendment, a number of the policy, implementation, and technical considerations in the department's prior analysis were resolved. The new and remaining policy and implementation considerations are included below.

As a result of the amendment, a revised revenue estimate has been provided.

Except for the discussion of this amendment, the department's analysis of SB 1336 as introduced January 5, 2000, still applies.

Policy Considerations

This bill would provide a credit equal to 100% of the expenses or costs that would qualify for this credit. Generally, credits are based on a percentage of the expenses or costs associated with the credit.

This bill would allow a credit for a deductible expense, thereby providing a double benefit for the guaranty and other fees paid or incurred. In many cases, the deduction for an expense that generates a credit is reduced or eliminated to minimize or eliminate this double tax benefit.

This bill would provide a credit to businesses located in enterprise zones that would not be allowed to businesses located in other economic development areas. Also, tax incentives allowed to businesses in enterprise zones typically contain certain restrictions, such as allowing credits to be used against only the tax attributable to income earned in the zone. The credit provided by this bill is not so limited.

Implementation Considerations

It is unclear which taxpayer, if any, is entitled to receive the credit for a guaranty fee. That is because the lender pays the guaranty fee to the SBA upon obtaining guaranteed financing. The lender may pass on the guaranty fee to the borrower, but the borrower would pay this passed-on amount to the lender, not the SBA.

In addition, since guaranty fees are paid by the lender and it is unclear if the lender passes on those fees as "guaranty fees" or some other type of fee for many borrowers it is unlikely they would be allowed to claim the credit for indirect guaranty fees passed on by the lender because lender costs, fees, etc., are limited to \$1,000 per year and the guaranty fees for average SBA loans in California are greater than this amount.

The author's staff has indicated it is the author's intent to allow the credit to the borrower, not the lending entity.

The part of the credit directed at lender costs, fees, etc. is not limited by the requirements for county unemployment rate or enterprise zones. As a result, any borrower that receives financing from the SBA would be eligible for the credit. The author's staff has indicated it is the author's intent that this portion of the credit have the same location requirements as the guaranteed fee credit portion of the bill. Therefore, the bill should be amended to reflect the author's intent.

This bill refers to the state average unemployment rate for the 12 months preceding the date the loan proceeds are disbursed and the guaranty fee is paid. It is unclear if the unemployment rate data are available and continuously updated for 12-month periods on a county-by-county basis.

In addition, it seems possible that the loan proceeds could be disbursed in one month and the loan guaranty fee paid in another. Therefore, it would be unclear which month to use for applying the unemployment rate.

Once the implementation concerns are resolved, implementing this bill would not significantly impact the department's programs and operations.

Tax Revenue Estimate

This revenue estimate reflects the author's intent which was to limit the additional other lender fee credit to the same location requirements as the guaranty fee.

This bill is estimated to result in revenue losses under the Personal Income Tax Law and Bank and Corporation Tax Law as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 1999 Enactment Assumed After June 30, 2000 \$ Millions		
2000-01	2001-02	2002-03
-\$2	-\$5	-\$7

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

With the addition of the \$1,000 credit for loan-related fees and expansion of the availability of the guaranty fee credit, the revenue impact from this bill has been increased from a minor loss in 2000-01, \$1 million loss in 01-02, and \$2 million loss in 02-03.

The revenue impact for this bill will be determined by the amount of loan guaranty fees and certain other fees paid by businesses located in enterprise zones or certain high unemployment counties that can be applied against available tax liabilities.

This estimate was developed in the following steps. First, according to the SBA, the total number of approved and guaranteed loans for California businesses was 8,096 for tax year 1999. Second, this number was increased 2% per year to allow for growth, generating 8,258 loans for 2000. According to the same source, the average loan amount for California was \$250,000. SBE guarantees 75% of each of its loans or an average of \$187,500 (\$250,000 x 75%) per loan. The percentage of the guaranty fee ranges from 2% to 3.85% depending on the portion of the loan that is guaranteed. For this analysis it was assumed 2.5% on average would be applied as the guaranty fee, generating a total fee of \$4,688 per loan (\$187,500 x 2.5%).

Third, the total number of loans was multiplied by the average guaranty fee, resulting in approximately \$38.7 million of fees for 2000 ($\$4,688 \times 8,258$). Fourth, this number was adjusted downward to reflect only businesses located in those counties that would have at least 150% of the California unemployment rate and businesses located in enterprise zones.

Currently 22 counties in California have an unemployment rate of 150% the state unemployment rate as of December 31, 1999. For these counties, total employment is 1.64 million out of the 15.7 million statewide, or 10.4%. In addition to these counties, an unknown number of employees are located in enterprise zones. As a proxy for this analysis, the total employment of 2.15 million for major cities within enterprise zones, or 15.3% of total urban employment of 14 million ($2.15/14 = 15.3\%$) was used. Employment statistics is an indicator of economic activity in these counties and enterprise zones. It was assumed for this analysis that 25.7% of the total \$38.7 million in guaranty fee payments would qualify businesses for the tax credit, generating a total credit amount of \$9.9 million for tax year 2000 ($\$38.7 \times 25.7\%$).

In addition, qualifying taxpayers would be allowed a maximum credit of \$1,000 for other fees (lender, appraisal and administrative) associated with obtaining a small business loan. According to the SBA, qualifying taxpayers pay an additional packaging fee that consists of all lender, appraisal and administrative fees. These fees range from \$500 to \$1,000 depending on the type of loan. For this analysis, it was assumed that the average fee would be \$750 for each qualifying taxpayer, or a credit amount of \$6.2 million for tax year 2000 ($8,258 \times \$750$). This number also was adjusted downward to reflect eligible businesses, generating a credit of approximately \$1.6 million for tax year 2000 ($\$6.2 \times 25.7\%$).

Combining these two elements, the total generated credit amount for tax year 2000 is projected to be approximately \$11.5 million. It was assumed that, on average, 12.5% of generated credits would be applied against available tax liabilities in the first year. The low usage rate was used because start-up companies generally have lower tax liabilities or operating losses.

BOARD POSITION

Pending.